WRITTEN TESTIMONY OF

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BEFORE THE

FEDERAL ADVISORY COMMITTEE ON THE AUDITING PROFESSION
UNITED STATES DEPARTMENT OF THE TREASURY

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Chairman Levitt, Chairman Nicolaisen, members of the Committee, Treasury staff and Observers:

Thank you for the opportunity to submit this written testimony. I am the General Counsel of Crowe Chizek and Company LLC (Crowe), a position I have held since June of 2006. Prior to that time, I held several General Counsel positions and have been in the practice of law for 35 years. I have been asked to comment on portions of Sections VI and VII of the Committee's Draft Report of May 5, 2008 and possible recommendations concerning greater transparency for audit firms performing audits of public companies found in those Sections.

In making this submission I keep very much in mind that it is the Committee's intent to improve audit quality and to increase competition among audit firms. We agree with both of those goals. We believe that transparency proposals that are focused on informing the public and/or clients of an audit firm's commitment to audit quality should be supported, however, a number of the proposals do not seem to hit the mark.

We agree with the draft Report that:

> "requiring firms to disclose indicators of audit quality may enhance not only the quality of audits provided by such firms, but also the ability of smaller auditing firms to compete

with larger auditing firms, auditor choice, shareholder decision making related to ratification of auditor selection, and PCAOB oversight of registered auditing firms."[1]

Such indicators of audit quality would need to be developed over time, be tailored to the US liability environment and for the size and scope of the audit firm in question. Careful attention should be paid to enhancing the ability of smaller firms to compete in the provision of audits to publicly traded companies. The development of objective criteria focused on audit and firm quality should create a more competitive market place for audit firms of all size. The draft Report, itself, recognizes the substantial and difficult task that would face the PCAOB in developing and monitoring such a reporting scheme.[2] Carefully selected and reported criteria would almost certainly enhance audit quality.

Public financial transparency patterned after foreign jurisdictions, in the current US regulatory and legal liability environment would be damaging to US audit firms. In some of the foreign jurisdictions class action shareholder suits are not permitted against auditors. As has been stated in other testimony, US audit firms face the repeated possibility of broad shareholder class actions even if the quality of their audit is superior and such suits can have catastrophic results in certain circumstances. The provision of publicly available financial data for the plaintiffs in such actions will only serve to enhance the risk, increase the dollar amount of settlements and reduce the number of medium and small audit firms that will enter into or stay in the market for publicly traded clients. Practice protection costs are material to a number of audit firms. I believe that to require public financial disclosure will drive up such costs by further unbalancing the negotiating position of the audit firms in litigation regardless of the facts of the case. On this topic I also note that the regulators and particularly the PCAOB have all of the authority necessary to gather

[1] Draft Report VII at page 11.
[2] Draft Report VII at 11 fn 44.

all of the financial information from audit firms to perform their oversight functions and determine audit quality while maintaining audit firm information in confidence.

The general financial risk faced by auditors of public companies does not result from the proposed transparency rules, however, those risks are very real and should be considered. At Crowe, we have so far been able to obtain professional liability coverage to transfer risks to the extent we consider commercially appropriate, although such coverage does not protect us from every potential catastrophic loss. We understand that our larger competitors are not always able to obtain desired coverage, and we have been told by our insurance consultants and underwriters that our Firm's growth, in both size of client and sophistication of practice, could soon place us in a similar position. Our management is actively managing our risk transfer structure and is continually assessing whether limits on our ability to transfer risk in commercially viable insurance transactions might slow our growth and development. While the owners of our firm are proud of our firm's growth in both size and capability, we also believe that from a public policy perspective Crowe is the type of firm which can add another meaningful option for hundreds of public companies considering high quality, cost effective audit solutions. Because of this point of view, we are concerned that the very real risk of catastrophic liability is not more firmly addressed within the report. In corporate failures where wrong-doing exists, the wrong-doer is usually within the failed company, which creates the unfortunate circumstance that those who should pay are unable to pay. Sometimes the auditor shares culpability, however, it can also be the case that the auditor is assigned disproportionate liability or liability where none should exist because of the deep pockets dynamic. Nowhere else in our tort system does such a large disproportionate transfer of financial loss take place. Moreover, even if we at Crowe are able to transfer our risk for one such occurrence it is likely that we would be unable to do so twice. If we are unable to obtain the insurance coverage necessary to commercially transfer risk at the

levels we believe appropriate, our ability to more broadly compete with the large public company audit firms will be diminished.

In assessing transparency proposals that would require the public disclosure of an audit firms private financial statements and information one must begin to look at the purpose that it would serve and what competitive effects it might have. Publicly traded companies are required, by law, to provide their owners with the information necessary to determine the company's performance. Financial information is an important part of that disclosure. Those shareholders then have the ability to make decisions concerning their investment and the governance of the company. There is no similar purpose to be served by the public disclosure of private financial information concerning audit firms owned by their partners. To date there has been no showing that any director of a publicly traded company would be aided in determining auditor quality by having access to audit firm financial information.

As previously stated it is our belief that publication of audit firm financial statements serves no regulatory purpose but may, in addition, have the unintended consequence of limiting the ability of mid sized firms,[3] such as Crowe, to continue to expand their service offerings to a wide range of public companies and preventing smaller audit firms from entering the competition for public audit clients thereby exacerbating the concentration issues. Public company audits often represent a reduced share of an audit firm's revenue than it does for the largest audit firms. The provision of internal financial data by audit firms may put them at a competitive disadvantage with audit firms that do not so report when bidding on: Audit services for private companies; non-audit services; in the hiring process as the financial disclosure will provide some insight to pay and benefits; and when competing against the much larger firms when certain

[3] AUDITS OF PUBLIC COMPANIES Continued Concentration in Audit Market for Large Public Companies Does Not Call for Immediate Action **January 2008 GAO-08** (GAO Report) identifies Crowe, McGladrey and Pullen LLP, Grant Thorton LLP and BDO Seidman LLP as midsize firms. See Table 2 at page 40.

financial or other metrics favor larger firms. Examples of the latter might be such things as internal training hours and staff ratios. Even the GAO in its report on market concentration could not conclude that there was any competitive benefit in requiring the proposed disclosure of audit firm financial information.[4]

Rather than expend the resources necessary to prepare and publicly disclose financial information together with the competitive disadvantage with respect to audit firms that do not report, the partnership of smaller firms may elect to opt out of the public company market altogether resulting in decreased competition particularly for mid sized and smaller audit clients. Crowe is one of the audit firms that reports to and is annually examined by the PCAOB and competes for international audit clients through membership in Horwath International Association (Horwath). Each member firm of Horwath is a separate and independent legal entity. Crowe and its affiliates are not responsible or liable for any acts or omissions of any other member of Horwath, however, it is my belief that the public disclosure of Crowe financial information may result in increased exposure to Crowe to lawsuits no matter how ill founded for the actions of others.

I thank the Committee again for this opportunity to submit this written testimony.

Robin G. Munden

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[4]GAO Report at pages 52-53.